

Before the
Illinois Commerce Commission

Docket No. _____

In the Matter of

Approval of an Increase and
Adjustment of Rates and Charges for
Water Utility Service Sold by
Lake Wildwood Utilities, Corp. within
Marshal County

Direct Testimony of

Steven M. Lubertozi
Director, Regulatory Accounting

for

Lake Wildwood Utilities, Corp.

September 25, 2001

1 **Q. Please state your name and business address.**

2 A. My name is Steven M. Lubertozi. My business address is 2335 Sanders Road,
3 Northbrook, Illinois 60062.

4
5 **Q. What is your occupation?**

6 A. I am the Director of Regulatory Accounting for Utilities, Inc. and its subsidiaries.
7

8 **Q. Please summarize your professional background?**

9 A. I have been employed by Utilities, Inc. since June of 2001. Since that time I have
10 been involved in many phases of rate-making in several regulatory jurisdictions. I
11 am a Certified Public Accountant. I graduated from Indiana University in 1990. I
12 had four years of public accounting/financial analysis experience prior to joining
13 Utilities, Inc. I am a member of the American Institute of Certified Public
14 Accountants, the Illinois CPA Society, and an Associate member of the Association
15 of Certified Fraud Examiners.
16

17 **Q. Please explain your job responsibilities with Utilities, Inc.?**

18 A. My responsibilities include: financial analysis of individual subsidiaries of Utilities,
19 Inc., preparation of applications for rate relief, facilitation of commission audits,
20 and the submission of financial testimony and schedules to support a request for
21 an increase in rates. In addition, I am responsible for the regulatory activities of
22 the wholly owned subsidiaries of Utilities, Inc.
23

24 **Background**
25

26 **Q. Please describe Lake Wildwood Utilities, Corp.?**

27 A. Lake Wildwood Utilities, Corp. is a wholly owned subsidiary of Utilities, Inc. (UI).
28 Water Service corporation (WSC) manages the operation for all of UI's water and
29 wastewater systems including Lake Wildwood. WSC provides management,
30 administration, engineering, accounting, billing, data processing, and regulatory
31 services for the utility systems. WSC's expenses are assigned directly to a utility or

1 distributed to the various companies pursuant to a formula that has been approved
2 by the Commission.

3 Lake Wildwood provides water service to approximately 390 usage customers and
4 about 1,400 availability customers in Marshall County. Lake Wildwood's current
5 rate structure was approved pursuant to the Order No. 98-0048 dated October 21,
6 1998.

7
8 **Rate Relief**
9

10 **Q. Mr. Lubertozi, what is the purpose of your testimony here today?**

11 A. The purpose of my testimony is to explain to the Commission why Lake Wildwood
12 Utilities, Corp. has requested an increase in water rates. I will also discuss some of
13 the factors that have contributed to the need for the increase and the impact of the
14 increase on our customers. I will present and describe schedules showing the
15 overall cost of capital and proper rate of return on rate base. In addition, I will
16 sponsor the Company's financial exhibits.

17
18 **Q. Why is Lake Wildwood Utilities, Corp. requesting rate relief at this time?**

19 A. A rate increase is necessary to allow the utility to recover the reasonable and
20 prudent costs of providing service and an opportunity to earn a fair and reasonable
21 rate of return on its invested capital. Rates granted in 1998 do not reflect the 3
22 years of rising costs, many of which result from stringent federal environmental
23 regulations and increase investment. For these reasons the utility is not able to
24 achieve a reasonable rate of return on its investment. Rate relief is essential to
25 ensure the continued availability of capital at a reasonable cost and to maintain a
26 high and professional level of service. Under the present rate schedule, Lake
27 Wildwood is not earning a fair and reasonable return on its investment. After
28 making pro forma adjustments to the December 2000 test year for known, fixed
29 and measurable changes Lake Wildwood Utilities, Corp. has an overall return of
30 5.07%. The proposed rates will allow the company to earn a 10.06% overall rate of
31 return. This information is supported in the financial statements attached hereto
32 as **Lubertozi Exhibit One.**

1 Q. Mr. Lubertozzi, what factors, or changes in the cost of service, can you point
2 to that have contributed to the need for the requested increase?

3 A. The age of the system is a factor in the cost of maintenance to be done. As the
4 systems ages, the cost of maintenance increases. In addition, Lake Wildwood has
5 spent a considerable amount of time and money replacing service lines to ensure
6 customer satisfaction and water delivery. Lake Wildwood Utilities, Corp. is
7 committed to maintaining clean, safe, professional facilities. Our facilities are
8 visible throughout the communities we serve.

9

10 **Rate Analysis**

11 Q. What are the present water rates for Lake Wildwood Utilities, Corp. and when
12 did they become effective?

13 A. The present rate became effective on October 21, 1998 and are as follows:

14	Base Facilities Charge	\$9.00
15	Gallorage Charge	\$3.62 per 1,000 gallons

16

17 The current average consumption for residential customers in Lake Wildwood is
18 approximately 2,900 gallons per months. This equates to a monthly bill of \$19.50.

19

20

21 Q. What are the proposed water rates for Lake Wildwood Utilities, Corp. and their
22 impact of the average customer?

23 A. The proposed rate are as follows:

24	Base Facilities Charge	\$11.70
25	Gallorage Charge	\$4.69 per 1,000 gallons

26

27 Based on the average consumption, the customers' monthly bill will be \$25.30 or
28 an increase of \$5.80 per month.

29

30 **Cost of Capital**

31

32 Q. What if the cost of capital to Lake Wildwood Utilities, Corp?

33 A. The cost of capital of Lake Wildwood Utilities, Corp. is determine by using UI's
34 capital structure. These cost of capital percentages are then used to ascertain the

1 overall cost of capital for Lake Wildwood Utilities, Corp. The capital structure and
2 cost rates that I proposed to use in this proceeding are as follows:

3

	<u>Weight</u>	<u>Cost</u>	<u>Weighted Cost</u>
Debt	50.02%	8.62%	4.31%
Equity	<u>49.98%</u>	<u>11.50%</u>	<u>5.75%</u>
Overall	<u>100.0%</u>		<u>10.06%</u>

4
5

6 **Q. Why must one determine the overall cost of capital for a public utility?**

7 A. The proper balance of rate payer and shareholder interest occurs when the
8 Commission authorizes a public utility a rate of return on its rate base equal to its
9 overall cost of capital. If the authorized rate of return on rate base exceeds the
10 overall cost of capital, then rate payers bear the burden of excessive prices.
11 Conversely, if the authorized rate of return on rate base is lower than the overall
12 cost of capital, then the utility will be unable to raise capital at a reasonable cost.
13 Ultimately, the utility may be unable to raise sufficient capital to meet demands for
14 service, thereby impairing service quality. Therefore, ratepayers interest are served
15 best when the authorized rate of return on rate base in neither higher nor lower
16 that the overall cost of capital.

17
18 **Q. Please define "overall cost of capital"?**

19 A. The overall cost of capital equals the sum of the costs of the components of the
20 capital structure (debt and common equity) after each is weighted by its proportion
21 to total capital.

22
23 **Q. How does Lake Wildwood raise capital?**

24 A. Capital for Lake Wildwood is raised by Utilities, Inc. Lake Wildwood Utilities, Corp.
25 is a wholly owned subsidiary of Utilities, Inc. The source of this capital is banks
26 and large lending institutions

27
28 **Q. How did you determine the cost of debt to Lake Wildwood?**

29 A. The 8.62% cost of debt is the embedded cost of debt of the Utilities, Inc., the parent
30 company of Lake Wildwood, as of December 31, 2000. This percentage is
31 consistent with past Illinois Commerce Commission practice.

1 **Q. How did you derive the cost of equity used in your calculation?**

2 A. Today's embedded cost of debt of the consolidated group is approximately 8.62%.
3 The equity investor is entitled to a premium over the return to the debt holder .
4 because of the additional risk he takes. It would not be unreasonable to add 2% to
5 4% to develop a range of reasonableness for the appropriate return to be used to
6 set rates. The debt holder has first claim on the assets and earnings of the
7 Company. His claims must be satisfied before funds are available to the equity
8 shareholder.

9
10 In addition, a risk free investment, thirty-year treasury bonds, currently yields
11 approximately 5.35%. Utility bonds available to investors are a higher risk than
12 government bonds. Also available to investors are equity securities of large
13 companies. These are publicly traded securities paying dividends and having the
14 advantage of liquidity. Naturally, the market would favor any of these securities
15 over the equity in a small company with non-traded securities, such as Lake
16 Wildwood. It would be reasonable to add a premium of 5 to 7% to the cost of 30-
17 year treasury bonds to determine the cost of equity to Lake Wildwood. Also, in
18 Utilities, Inc.'s last rate case (Carolina Water Service, Inc., Order No. 2001-887,
19 dated August 27,2001) the Public Service Commission of South Carolina found that
20 11.50% is an appropriate return on equity.

21
22 In view of the proceeding information, I believe that 11.50% is the minimum cost of
23 equity and that an overall return of 10.06% is reasonable.

24
25 **Filing Procedures**

26
27 **Q. Why is Lake Wildwood Utilities, Corp. filing under the Standard Rate Case**
28 **Procedures instead of the Short Form Procedures that are in place for a**
29 **company the size of Lake Wildwood Utilities, Corp.?**

30 A. Utilities, Inc. has determined that our short form filings are conducted in the same
31 manner as a general rate filing. This is because Utilities, Inc. has a staff of
32 accounting and ratemaking professionals. Additionally, under the short form
33 process there is no formal procedure for seeking a mediation of disputed
34 adjustments made by the Staff to the utility's revenue requirement. This can be
35 unfair to the utility.

1

2 **Q. Will filing under the Standard Rate Case Procedure increase the cost to the**
3 **ratepayers?**

4 A. Yes, but the cost should be minimal. The company does not expect to utilize an
5 attorney to litigate this case. The Commission has allowed other subsidiaries of
6 Utilities, Inc. to use company, non-attorney representation in the following rate
7 proceedings: Lake Wildwood, Order No. 98-0048, Cherry Hill Water Company,
8 Order No. 94-0368, County Line Water Company, Order No. 94-0497. In the above
9 mention proceedings eliminating attorney representation save the ratepayers
10 thousands of dollars.

11

12 **Q. Does this conclude your testimony?**

13 A. Yes it does.